



**Directorate of  
Intelligence**

~~Secret~~

25X1

# **Potential Gorbachev Initiatives in Foreign Trade**

25X1

**An Intelligence Assessment**

~~Secret~~

*SOV 85-10220X  
December 1985*

*Copy* **530**

**Page Denied**



**Directorate of  
Intelligence**

**Secret**

25X1

# Potential Gorbachev Initiatives in Foreign Trade

25X1

**An Intelligence Assessment**

This paper was prepared by [redacted] of the  
Economic Performance Division, Office of Soviet  
Analysis, with contributions by [redacted]  
Economic Performance Division; [redacted]  
Domestic Policy Division; [redacted]  
Strategic Policy Division; several analysts from  
Defense Industries Division; and [redacted]  
Office of Central Reference. Comments and queries  
are welcome and may be directed to the Chief,  
Economic Performance Division, SOVA, [redacted]

25X1

25X1

25X1

25X1

25X1

25X1

25X1

**Secret**

*SOV 85-10220X  
December 1985*

Secret

25X1

### Potential Gorbachev Initiatives in Foreign Trade

25X1

#### Key Judgments

*Information available  
as of 26 December 1985  
was used in this report.*

General Secretary Gorbachev's economic modernization program will depend, in part, on expanded imports of Western technology and equipment. Although Moscow is looking toward Eastern Europe to provide the lion's share of such imports, Western technology and equipment, particularly if used more effectively than in the past, could make an important contribution to raising the quality and efficiency of Soviet civilian production. With the overall level of imports likely to be constrained by limitations on Soviet hard currency earnings, the need to maximize the impact of what is imported is critical. [REDACTED]

25X1

Gorbachev clearly recognizes the need to improve Soviet utilization of Western technology. Unlike the defense sector, where the priority attached to rapidly assimilating Western technology is backed by a massive and skilled research and development (R&D) infrastructure, the civilian sector is not set up to take full advantage of imported technology. Some defense industry practices, including close working relationships between end users and R&D facilities and accountability for the assimilation and diffusion of Western technology, could be applied to the civilian sector. Gorbachev has stated that civilian industry should, in general, emulate defense industrial management practices, and his announced program to substantially upgrade civilian R&D capabilities could provide a more receptive environment for foreign technology. Addressing the resource issue, however, is another matter. His appointment of outsider Boris Aristov as Foreign Trade Minister could well result in a major personnel shakeup designed to make the foreign trade bureaucracy more responsive to domestic clients' needs, including more direct participation by end users in contract negotiations. Already there are numerous rumors in Moscow that a major reorganization of the Ministry of Foreign Trade is imminent. [REDACTED]

25X1

In addition to improving the existing system, the General Secretary apparently believes that the USSR must alter the nature of its relationships with Western firms if it is to increase the effectiveness of imported technology and equipment. [REDACTED] past

25X1

- Allowing Western personnel to assist in managing Soviet production facilities, perhaps including control over certain aspects of production.
- Permitting on-site inspection by the Western partner of joint-venture and coproduction arrangements for quality-control purposes.

Secret

SOV 85-10220X  
December 1985

**Secret**

25X1

- R&D efforts that would involve Western scientific and technical experts working closely with their Soviet counterparts to develop new products and processes rather than the occasional visits to exchange information that are now the norm.
- Training facilities in the USSR that are staffed, in full or in part, with personnel from the Western firm.
- Foreign equity in Soviet production facilities.
- Soviet equity in Western production facilities. [redacted]

25X1

Soviet officials already have expressed interest in joint ventures entailing Western profit sharing and managerial presence. They have also taken an interest in engineering and production consultation with foreign experts in the energy sector and foreign assistance in setting up a training school with courses in drilling, well completion, and operation of offshore oil wells. Gorbachev may be willing to move quickly in this direction; [redacted]

25X1

25X1

25X1

Gorbachev understandably faces a number of difficulties in improving Soviet absorption of Western technologies. Personnel changes within the Foreign Trade Ministry will take time, and there will undoubtedly be strong resistance to any attempts to decentralize foreign trade decision-making. Even if agreement is reached on allowing expanded Western participation, Soviet suspicion of a foreign presence and the repugnancy of Western equity interests will limit the pace of contract signings. Western businessmen, for their part, are likely to react cautiously to Soviet proposals calling for coproduction and profit sharing. [redacted]

25X1

In sum, we expect meaningful changes in the conduct of foreign trade to be slow in coming. While innovative approaches may be adopted in high-priority areas such as energy, Moscow is not likely to move quickly along the lines taken by many of its East European allies. US technology is clearly preferred by the Soviets; to our knowledge recent Soviet interest in joint ventures has been broached mainly with US corporations. Soviet interest, however, has been tempered by continuing concern over US export controls and a need to guarantee against future trade and financial embargoes. Nonetheless, Gorbachev, like Brezhnev before him, would undoubtedly like to expand US-Soviet trade as a way to attack economic

**Secret**

**Secret**

25X1

problems. Paradoxically, he may have to show progress in improving economic performance if he hopes to attract Western participation in cooperation arrangements that tie the participants' profits to the successful operation of the venture. The Soviet leadership will also probably continue its efforts to influence US policy through US businessmen by holding out the possibility of expanded trade if technology and credit restrictions are eased or arms control agreements are reached.

25X1

**Secret**

Secret

25X1

## Contents

	<i>Page</i>
Key Judgments	iii
Introduction	1
Past Trends in Purchases of Western Equipment	1
Gorbachev's Economic Strategy and the Potential Role for Trade	4
Gorbachev's Current Approach Toward Trade	4
Focus on Eastern Europe	4
Role of Trade With the West	6
Limitations of the Current Approach	7
Innovative Strategies	8
Reform of the Foreign Trade System	8
Changing the Methods of Dealing With Foreign Entities	8
Recent Developments	9
Changes to the Foreign Trade Structure	9
Dealing With the West	12
Obstacles to Increased Western Participation	12
Prospects: A Middle Ground	13
Implications for the United States	14

Secret

Secret

25X1

## Potential Gorbachev Initiatives in Foreign Trade

### Introduction

*Proceeding from the tasks of scientific-technical progress, it is necessary to adopt a new approach to our foreign economic strategy. The current world trend is that in many countries the foreign trade is growing twice as fast as production. This is a powerful accelerator of the scientific-technical and economic development. Our country's foreign trade turnover has reached quite a sizable volume, R140 billion, but its rates of growth can and must be accelerated, and, what is the most important thing in this connection, deep structural changes must be made and both exports and imports must be made more progressive.*

*M. S. Gorbachev*  
11 June 1985

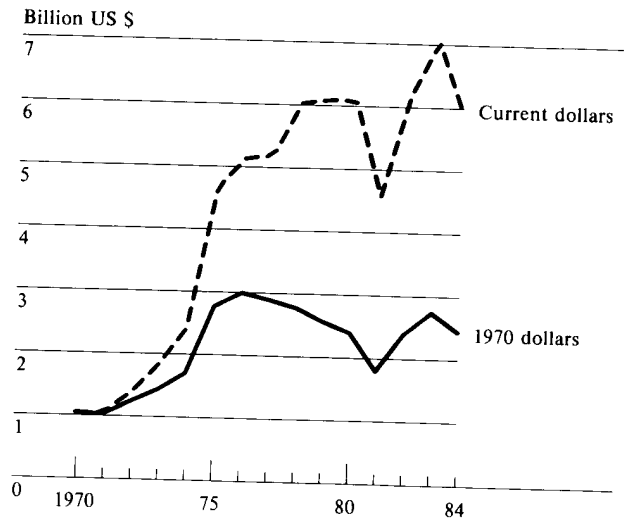
Recent statements by General Secretary M. S. Gorbachev, coupled with the sweeping personnel changes he has made in the party and government bureaucracy, hint that major changes in the management of the civilian economy are in the offing as part of his modernization program. While specific details of what role foreign trade will actually play are unknown, the naming of a new foreign trade minister and Moscow's recent interest in new types of cooperation with Western firms raise the possibility of substantial changes in Soviet foreign trade policy as it applies to the civilian economy.

### Past Trends in Purchases of Western Equipment

Throughout most of its history, the USSR has looked to the developed West to provide key technologies to help establish (during the late 1920s and early 1930s) and modernize (since the 1960s) priority sectors of the economy. This policy led to a rapid expansion of Soviet imports of Western machinery and equipment in the mid-1970s (see figure). While the share of machinery and equipment from hard currency countries is, according to our estimates, currently less than 10 percent of total machinery investment, purchases

### USSR: Hard Currency Machinery and Equipment Imports, 1970-84

25X1



307749 12-85

25X1

of Western equipment have been particularly important in improving production in the defense, chemical, metallurgical, oil and gas, and automotive industries.

25X1

25X1

While Western technology has made an appreciable difference to both civilian and defense industries, the USSR has not been particularly successful in assimilating and diffusing imported technology in the civilian sector (see inset for a description of the inadequacies of the foreign trade bureaucracy).<sup>1</sup>

25X1

<sup>1</sup> Assimilation is the mastering of new technology by a single end user. Diffusion is the use of it throughout the economy. In this paper the phrase "assimilation and diffusion" refers to all of the stages from initial Soviet interest in a technology to its economy-wide adoption.

25X1



Secret

### *Inadequacies of the Soviet Foreign Trade System*

*The monopoly of foreign trade, established by Lenin and concentrated mainly in the Ministry of Foreign Trade, has caused a number of inefficiencies that prevent the USSR from obtaining the most benefit from its foreign economic ties. The system separates the end users of imports and the producers of exports from their foreign counterparts and provides few effective incentives to encourage domestic enterprises to either rationally utilize imports or produce for export. While attempts have been made to overcome these problems, especially in the middle and late 1970s, the Ministry of Foreign Trade has effectively fought off any efforts to dilute its authority over foreign trade. In addition, many of the structural inadequacies of the foreign trade system are a reflection of deeper problems within the economic system itself.* [redacted]

*Soviet foreign trade organizations (FTOs), most of which are under the Ministry of Foreign Trade, are the legal entities authorized to negotiate and sign contracts with foreign entities for imports and exports. Judging by the emphasis given to select aspects of commercial negotiations, FTO officials are held responsible for (1) demonstrating that they have met the technical demands of the industrial ministry, which includes guarantees from the Western exporter on delivery and on-site performance of imported equipment; (2) obtaining the "best" terms available (that is, lowest price and availability of long-term loans carrying a low nominal rate of interest) when negotiating purchases of machinery and equipment. Attempts to negotiate price reductions can lead to protracted negotiations, often two to three times*

*longer than similar negotiations in the West, thus delaying the installation of needed technology. The long negotiation time combined with Soviet insistence on purchasing only "proven" technology guarantees that equipment will be less than state of the art by the time it is installed.<sup>a</sup> Furthermore, Soviet demands that extensive documentation be provided and adhered to allow for little flexibility in changing the contract to adapt to new circumstances.* [redacted]

*In addition, the criteria on which the performance of FTOs is judged do not necessarily take into account the requirements of the end user. Although industrial ministries and production associations (groups of enterprises—including factories, research institutes, and design bureaus—that are centrally managed to produce a product line or several related product lines) have been represented on FTO boards of directors since at least 1967, often there is still little contact between the FTOs and the end user, who is usually not represented on the negotiating team. Furthermore the FTO officials typically are not well versed in the needs of the end user. Consequently, purchases have been made that do not reflect the specific requirements of the end user and at times cannot even be used. This problem is complicated by the FTOs' desire to cut costs at the expense of quality.* [redacted]

25X1

25X1

25X1

25X1

25X1

25X1

25X1

[redacted] performance of Western equipment and technology is often below levels that would be expected in a Western setting; Soviet manning of such equipment is excessive compared with similar situations in the West; and the frequency and duration of breakdowns are much greater. Indeed, [redacted]

[redacted] Soviet managers were generally only as capable as managers in non-Asian developing countries in using foreign technology. Moreover, because of the time-consuming negotiation process and long delays in installing

Secret

Secret

*The Soviet system also provides few incentives to encourage end users to effectively use imported technology. In fact, pressure to meet production targets discourages the use of imported machinery and equipment (as well as innovations in general) because of the potential for disrupting current production. In addition, imported equipment is frequently delivered long before the facility where it is to be installed is ready (because of chronic construction delays) and may sit outside unprotected for a considerable length of time, resulting in damaged equipment.* [redacted]

*On the export side, the Soviet system provides little incentive for manufacturers to produce for export. While the domestic enterprises are paid a higher price for goods produced for export to compensate for the extra costs required to meet export specifications, factory managers argue that the price differential is not sufficient to cover the costs incurred. More important, the need to meet export specifications that differ from domestic standards interferes with the ability to meet output targets. The FTOs, on the other hand, prefer to keep the price paid to the producers as low as possible since their performance is measured by their profitability, that is, the difference between the price they pay the domestic producer and the price they receive from the foreign customer. Thus the Foreign Trade Ministry tends to resist efforts to increase the producer's incentive to expand production for export.* [redacted]

*As an incentive for producers to expand export production, enterprises have been allowed to retain since 1964 a portion of their hard currency earnings*

*for the purchase of Western equipment and materials. This law, however, has frequently been ignored. The Bank for Foreign Trade (Vneshtorgbank) often drags its feet and even refuses to allocate the hard currency (technically owned by the enterprises) when requested. Moreover, the enterprises are limited to purchasing machinery, licenses, and raw materials with their foreign exchange. They cannot purchase consumer goods that could be used as incentives to increase their workers' productivity.* [redacted]

*Finally, bureaucratic rivalries among the Ministry of Foreign Trade, the State Committee for Science and Technology (GKNT), and Gosplan further complicate and prolong foreign trade decisionmaking. The Foreign Trade Ministry and GKNT, for example, have overlapping responsibilities in license trade and compensation agreements—a situation that can lead to disruptive departmental and personal wrangling. Such problems have been compounded by an entrenched aging leadership that has been resistant to change. Both former Foreign Trade Minister Patolichiev, who had served since 1958 and had a close relationship with Brezhnev, and former Gosplan Chairman Baybakov, who held high-level posts in the economic bureaucracy since 1940, probably were regarded by the new leadership as obstacles to change.* [redacted]

25X1

25X1

25X1

25X1

*imported equipment, the technology is often effectively dated by the time operation commences.* [redacted]

*In the late 1970s, the Soviets themselves started to express their disappointment over the failure of imports from the West to make the expected contribution to industrial output. For example, Leonid Brezhnev questioned the reflex action of Soviet managers*

*who instinctively cry "Buy Foreign Technology" the minute they encounter a problem. Even as recently as this spring, the President of the Soviet Academy of Sciences, Anatoliy Aleksandrov, complained in an article that not only is imported technology badly used but also that "the blind copying of the latest*

25X1

Secret

Secret

scientific and technical ideas (or frequently what was the latest) is often what leads to our falling behind." He further stated that, by importing machinery instead of producing it domestically, Soviet enterprises are denied the R&D support they would otherwise have.

This dissatisfaction, combined with a growing backlog of imported but uninstalled equipment, played a role in the subsequent slowdown in equipment orders. Other contributing factors include:

- A rapid runup in debt in the early 1970s that led the Soviets to limit new hard currency borrowings. Moscow's conservative borrowing policy probably has been reinforced by the debt problems of its East European allies.
- Concern over becoming overly dependent on Western equipment, which was heightened by Western sanctions of the late 1970s and early 1980s.

As a consequence of these concerns, Soviet imports of machinery and equipment fell steadily in real terms (measured in constant 1970 dollars) from the peak 1976 level, with the exception of a temporary upswing in 1982 and 1983 as deliveries of equipment for the Siberia to Western Europe pipeline were made.

#### **Gorbachev's Economic Strategy and the Potential Role for Trade**

Since Gorbachev became General Secretary in March, official pronouncements emphasizing the importance of employing new technologies to modernize industry have become more urgent. Gorbachev has emphasized that it is the same high-technology industries that are leading modernization programs in the West—machine tools, robots, microelectronics, computers, and telecommunications—that must now lead the way in the USSR. He made it clear that scientific and technological (S&T) progress in these industries is critical to the production of better machinery, and that, when spread throughout industry, such progress will spur economic growth to levels where "adequate living standards, defense capabilities, and investment can be maintained."

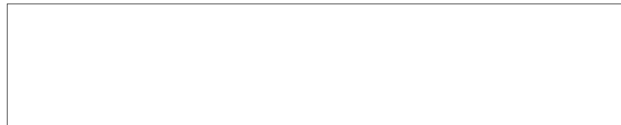
Gorbachev has declared industrial modernization to be the 12th Five-Year Plan's (1986-90) highest priority.<sup>2</sup> By 1990 he has promised that one-third of the Soviet capital stock, including half of all machinery, will be new. This ambitious goal is to be accomplished through investment shifts benefiting high-technology industries, management and organizational reforms to speed innovation, and programs to change the attitudes and work habits of managers and workers. Gorbachev also has stressed the need for the civilian sector to emulate the practices of the defense industries. The successes of Soviet defense industries in assimilating Western technology, however, have resulted primarily from priority access to scarce resources—a condition that cannot be applied economywide (see inset for a description of the defense sector's use of imported technology).

The ambitious targets set by Gorbachev, especially for increases in the machine-building sector, will be difficult, if not impossible, for the Soviets to meet without increased imports of machinery and equipment, as well as a more effective use of such imports than is currently the case. To achieve his announced goal that 50 percent of all machinery will be new by 1990, for example, the Soviets must accelerate the annual output of producer durables to rates unmatched since the early 1970s. Additionally, the machines must be tailored to meet the unique needs of plants being remodeled—a difficult task for an industry accustomed to manufacturing large lots of a small variety of equipment for use in plants being constructed under highly standardized designs.

#### **Gorbachev's Current Approach Toward Trade**

##### **Focus on Eastern Europe**

Gorbachev is undoubtedly expecting that Eastern Europe will supply the USSR with most of the machinery and equipment that domestic producers are not able to supply. For over a decade, the Soviets



25X1

25X1

25X1

25X1

25X1

25X1

25X1

Secret

Secret

---

*Drawing From the Defense Experience*

---

*The USSR has generally been quick to capitalize on Western technological advances when it comes to defense applications, although there are numerous cases of problems or even failures. Soviet designers have successfully applied Western military technology and design concepts in several hundred military R&D programs, thereby reducing engineering risk and shortening weapons development and production leadtimes. Similarly, manufacturing equipment and know-how acquired for specific military production programs have significantly improved the quality and efficiency of defense production and enabled the Soviets to bring manufacturing processes on line years earlier than domestic technology would support. Several factors account for the superior performance of defense industries:*

- Defense, with its priority claims on skilled technicians and advanced equipment, maintains a massive R&D establishment equipped for both indigenous technology development and the exploitation and reverse engineering of Western technology.*
- Defense R&D institutions usually specialize in relatively narrow areas, usually working closely with production facilities. Industrial ministries within the defense sector also maintain lead technology development organizations designed to aid in industrywide assimilation.*
- Assimilation goals are focused, clearly defined, and closely monitored. In the process of targeting acquisitions, defense requestors must specifically identify planned applications and later assess how the*

*acquisitions were handled through a formal reporting system that is pervasively and aggressively enforced.*

25X1

*Performance in civilian industries is poorer because they have fewer resources and incentives to improve products through technological advance and are under less pressure to reduce development leadtimes. Their efforts to acquire and exploit foreign technologies suffer further from looser integration into the R&D and production planning process and less strict accountability in exploitation:*

- Civilian R&D institutes are underequipped and understaffed relative to their defense counterparts; they are less concerned with the acquisition and effective application of new technologies; and they work less closely with production enterprises.*
- Industrial ministries often acquire individual items of equipment and technology without adequately assessing how they are to be used in specific production programs; imports, as a result, are often found to be unsuitable by the actual end users. Followup reporting on how—or even if—acquisitions are actually used is, at best, haphazard.*
- Equipment and technology imports are often acquired as part of integrated turnkey projects; this makes it difficult to adapt specific equipment and processes to Soviet industrial standards and technical support capabilities, which impedes diffusion.*

25X1

have pushed hard within the Council for Mutual Economic Assistance (CEMA) to integrate more closely the Soviet and East European economies and to raise the quality of the goods they produce to world standards. The creation early this year of a CEMA committee for machine building and the conclusion of specific long-term S&T agreements serve these goals.

Gorbachev's statements suggest that he plans to pursue these longstanding goals with renewed vigor with an eye to Eastern Europe's ability to contribute significantly to his industrial modernization program. Recent appointments of two men with substantial East European experience—Boris Aristov as Minister

25X1

Secret

Secret

of Foreign Trade and Nikolay Talyzin as Chairman of Gosplan—reflect the importance Gorbachev attaches to the region. Under Gorbachev's tenure, the leadership has made it clear in public speeches and private negotiations that continued access to past levels of Soviet oil and raw materials hinges on Eastern Europe's ability to supply larger amounts of high-quality goods. In Soviet eyes, increased imports of high-quality East European machinery and equipment could provide an important supplement to internal resources for capital improvements. [ ]

Eastern Europe's well-developed and relatively sophisticated scientific and industrial base is clearly important to the Soviets as a source of industrial technology. In many types of numerically controlled machine tools and microelectronics equipment, East Germany, Czechoslovakia, and Hungary are technically equal or superior to the Soviet Union. The East Germans and the Czechoslovaks, in particular, have done much R&D on computerized flexible manufacturing systems. As part of the division of labor in CEMA's industrial specialization scheme, East Germany, Bulgaria, and Hungary have developed computer peripherals and software industries and are the USSR's primary source of supply for such products as tape and disk drives. Meanwhile, East Germany, Bulgaria, and Czechoslovakia are at least on a par with the Soviets in producing simple "pick and place" industrial robots and are very active in R&D on more advanced sensory-controlled robots. East Germany dominates in the microprocessor technologies that robots and advanced machine controllers require, while its optics industry is at least equal to the USSR's. [ ]

Eastern Europe's technological progress relative to the USSR's probably reflects a combination of a well-developed and sophisticated scientific and engineering base and better access to Western technology. East European machine tools often use Western controller designs produced on license, and several East European countries have imported large amounts of micro-electronic production equipment. East European scientists and engineers enjoy a level and frequency of interaction with their Western counterparts normally unavailable to the Soviets and can participate in and even sponsor industrial research projects in the West. [ ]

Opportunities for improving the quality of technology in Eastern Europe or the amount obtainable by the Soviets are, however, limited over the next few years by a number of factors. Paramount are the competing Soviet demands that Eastern Europe do more for defense and that it adjust its energy demands to cope with diminished supplies of Soviet oil and raw materials. But there are also a number of technological limitations:

- The USSR already absorbs large shares of East European production in most high-technology industries, and large increases in exports probably would require expanded East European production capacity, which would take several years to achieve. 25X1
- The Soviets are pressuring the East Europeans to modernize capital goods industries, and this generally entails a standdown in established production operations.
- Dramatic increases in the quality of East European equipment would better enable manufacturers to market their products in the West, thereby earning hard currency and creating incentives for the East Europeans to divert high-quality exports from the USSR. [ ] 25X1

#### Role of Trade With the West

Imports of advanced Western technology, especially in machine building, electronics, and computers, could provide a boost to Gorbachev's modernization program. Limits on Soviet exports through the remainder of the decade, however, should severely constrain the level of imports for the period (see inset for an analysis of Soviet export prospects). On the basis of our estimates, the USSR would have to let its debt service ratio rise to between 25 and 40 percent by 1990 just to maintain real import capacity at the 1983 level.<sup>3</sup> Thus even a less conservative borrowing policy would give Moscow little or no room to substantially step up imports. [ ] 25X1

<sup>3</sup> These estimates are based on a range of potential export scenarios. Debt service ratio is defined as the percentage share of payments of principal and interest on Soviet debt in total hard currency receipts. 25X1

--	--

25X1

Secret

Secret

---

**Prospects for Exports**

*During the balance of the decade, the USSR—which counts on oil, gas, and arms sales for over 80 percent of its hard currency exports—is likely to face serious constraints on its ability to generate hard currency. Already this year, Soviet oil export revenues are expected to be down some \$3-4 billion, as a result of both last winter's severe weather and continuing oil production declines. While the potential exists for expanding gas exports, soft demand in Western Europe makes sizable increases in sales unlikely over the medium term. Even Soviet arms exports, which have been a lucrative hard currency earner, will face a tight market, making increased earnings from arms sales unlikely and reduced earnings a possibility.*

[redacted]

*Western businessmen generally consider the quality of most Soviet manufactured goods substandard and the availability of spare parts and servicing for such goods deplorable. Nevertheless, many Western businessmen who were recently interviewed stated that the best Soviet export possibilities within this category lie in the area of medium-technology machinery and commodities—such as construction materials and rubber products—that do not require a high degree of sophistication, if quality and servicing problems can be resolved. Gorbachev seems intent on improving the overall quality of manufactured goods, in part to make them more competitive on world markets and thus provide a base from which to expand exports of such items. Any of these efforts, however, could take five to 10 years to have any sizable effect and therefore would not have much of an impact on increasing exports through 1990.*

[redacted]

*In the interim, the Soviets may attempt to expand marketing of machinery and equipment in the less developed countries (LDCs), offering generally reliable although less sophisticated equipment at lower prices than Western competitors with attractive financing terms. The Soviets also could increase their efforts to participate in LDC development projects with Western firms, piggybacking their technology and services on more advanced Western offerings.*

[redacted]

---

Despite these financial constraints, the Soviets are moving ahead in negotiations with a number of Western firms for large projects in priority sectors such as energy, chemicals, and steel as the start of the 1986-90 Five-Year Plan approaches. Gorbachev, however, has put foreign trade officials on notice that massive imports are not in the cards and that the focus of the modernization efforts will fall on domestic resources and new ways to marshal those resources. This theme was reiterated in his recent *TIME* magazine interview (9 September 1985, pp. 22-29).

[redacted]

25X1

**Limitations of the Current Approach**

Gorbachev must take some action to make the foreign trade bureaucracy more efficient if he is to make more effective use of Western technology in his modernization effort. Past Soviet disappointment with the gains from imported equipment and technology are attributable, in part, to Moscow's highly centralized and compartmented approach to trade. Soviet firms and ministries seeking Western assistance must go through a lengthy competition process to secure a foreign currency allocation and subsequently work through a foreign trade bureaucracy that jealously guards its legislated authority to conduct negotiations with foreign enterprises.

[redacted]

25X1

With the Ministry of Foreign Trade's focus on getting the best commercial terms for any acquisition and the limited contact between Soviet end users and foreign suppliers, equipment and technology acquisitions do not always meet Soviet needs. For example, some of the equipment purchased for the Kama River truck facility would not fit into the buildings designed to hold it. Moreover, the controlled nature of the Soviet system makes it extremely difficult to seek out and conclude deals calling for sustained and detailed dialogue between the Soviet importing enterprise and its Western supplier. With some notable exceptions—such as the Kama River truck facility—purchase of Western technology is currently limited to the straight acquisition of licenses and equipment. Even scientific and technical cooperation agreements between Western firms and the USSR generally involve only occasional exchanges of delegations to discuss topics of mutual interest.

[redacted]

25X1

25X1

25X1

25X1

Secret

**Secret**

These failings are particularly critical in the high-technology area, where detailed documentation cannot fully substitute for continuing face-to-face dialogue, nor can it deal with all the problems that can develop during production. Moreover, the lack of continual contacts prevents routine updating of production processes that the Soviets have acquired from abroad and makes it difficult for Western firms to develop products and processes specifically suited to Soviet needs. [REDACTED]

- Changing the criteria by which FTO performance in negotiating import contracts is evaluated, giving greater weight to timeliness and satisfying the quality specifications of the end user.
- Improving the mechanism for planning foreign trade through greater use of quantitative analysis of the efficiency of exports and imports.
- Providing sufficient incentives to construction organizations to complete facilities and install equipment in a more timely fashion, especially imported equipment. [REDACTED]

25X1

25X1

Changes of a more structural nature would most likely involve granting end users a much greater say in negotiations for imports and greater contact between the export-producing enterprises and their foreign customers. Reforms could range from representatives of the end user being allowed to be present at all purchase negotiations with some form of approval/veto power to transferring control over the FTOs from the Ministry of Foreign Trade to the relevant industrial ministries or even to production associations. At the extreme, individual enterprises, at least selectively, could be given control over all foreign trade operations, including the flexibility to set their own export targets and conclude their own sales. [REDACTED]

25X1

25X1

### **Innovative Strategies**

To overcome such limitations, Gorbachev may opt for a more innovative strategy on importing from the West. While Gorbachev has yet to unveil major new approaches, it is worth remembering that several of the major actors for establishing foreign trade policy—notably the foreign trade minister and the Gosplan chairman—have only been in office a short time. Once a strategy is developed, it may well include changes in both the USSR's internal and external economic policy.<sup>4</sup> [REDACTED]

### **Reform of the Foreign Trade System**

Efforts to improve the foreign trade system could range from minor tinkering to broad structural reforms. Judging from Soviet writings and past initiatives, minor changes might include:

- Increasing the price differential between commodities produced for the domestic market and those for export.
- Permitting domestic enterprises to retain a larger share of the hard currency earned from their exports and/or taking additional steps to ensure that the enterprises actually have access to these earnings.

<sup>4</sup> Any changes that Gorbachev may make to the foreign trade system will undoubtedly be tied to his overall efforts to improve the efficiency of the Soviet economy. Moreover, success in increasing the effectiveness of foreign trade will be intrinsically linked to Moscow's ability to improve the performance of the economy as a whole. Unless sufficient incentive is provided to domestic producers to successfully incorporate imported technology in domestic manufactures and to produce high-quality goods, the impact of any improvement in the handling of import and export transactions will be minimal. [REDACTED]

### **Changing the Methods of Dealing With Foreign Entities**

To increase the flow of technology and offer conditions that would make Soviet manufactures more attractive to Western firms, the leadership could expand the forms of its cooperation with the West. Industrial cooperation arrangements between East and West have been in existence for quite some time, but the Soviets have limited their participation in such arrangements largely to the acquisition of equipment, often for complete plants, technical know-how, and some provisions for joint R&D. They have used these arrangements to a much lesser extent than the East Europeans to obtain Western managerial services, quality control, and coproduction provisions—all of which would require much closer contacts than the Soviets have been willing to accept. To broaden these arrangements, the Soviets would have to allow for increased ties between foreign firms and Soviet production enterprises and at least a de facto reduction in

25X1

25X1

**Secret**

Secret

the role of the Foreign Trade Ministry over the conduct of trade.<sup>5</sup> [ ]

If the Soviets were to expand the scope of industrial cooperation arrangements or, to quote Gorbachev, "to develop new forms of economic ties," Soviet contracts with Western firms might incorporate new elements such as:

- Allowing Western personnel to assist in managing Soviet production facilities, including perhaps control over certain aspects of production. Management of oilfield development in remote areas might be suitable to this type of arrangement.
- Coproduction arrangements permitting on-site inspection by the Western partner for quality-control purposes.
- R&D efforts that would involve Western scientific and technical experts working closely with their Soviet counterparts at either the Soviet or the Western partner's facilities for an extended period (months or even years) to develop new products and processes rather than the occasional visits to exchange information that are now the norm.
- Training facilities in the USSR that are staffed, in full or in part, with personnel from the Western firm.
- Foreign equity in Soviet production facilities.
- Soviet equity in Western production facilities. [ ]

The Soviets also might expand the role of their companies in the West in packaging, marketing, and servicing Soviet-manufactured exports through greater use of Western marketing techniques such as market surveys. As a way to improve their marketing and economic management skills, they could increase the number of students studying such subjects in Western business schools. [ ]

<sup>5</sup> The Soviets are already encouraging such ties between Soviet enterprises and those in other CEMA member countries. The recent creation of scientific-production associations with the Bulgarians and Czechoslovaks appears to be a new step in this direction. [ ]

## Recent Developments

### Changes to the Foreign Trade Structure

Even though a clear-cut policy is not yet evident, Gorbachev has made some moves to put his mark on the foreign trade system that suggest that he may be willing to adopt some of the innovative policies just discussed. Since August he has replaced many key personnel responsible for the formation and conduct of Soviet foreign trade. Boris Aristov, the new Foreign Trade Minister, has no previous connection with the Ministry and is likely to be receptive to wide-scale reform of the foreign trade apparatus (see inset for more details on Aristov). Likewise, the appointments of Nikolay Ryzhkov as Chairman of the Council of Ministers and Nikolay Talyzin as Gosplan Chairman presumably have removed major bureaucratic impediments within the upper levels of the government hierarchy to potential changes in the planning and implementation of more innovative foreign trade activities. [ ]

25X1

Already there are numerous rumors in Moscow that a shakeup of the Ministry of Foreign Trade is imminent. A Soviet foreign trade official recently told the US Embassy in Moscow that a major reorganization of the Ministry of Foreign Trade is likely early next year. While there are several proposals being considered, the one currently favored calls for greater centralization. It would reduce the number of FTOs from 47 to 10, bring FTOs now outside the Ministry under its jurisdiction, and reduce by half the number of deputy ministers. The proposal, however, does not appear to address the key problem of lack of responsiveness of FTOs to the needs of the end users. [ ]

25X1

25X1

In addition, the Soviet leadership under Gorbachev has made some minor changes in the foreign trade system. A recent Central Committee decree is designed to encourage the production of goods for export. In general, the decree calls on ministries, associations, and enterprises to improve the competitiveness of Soviet exports by raising the technical level and quality of exportable products. Specific measures included in the decree were:

25X1

- An additional price supplement of up to 20 percent on current supplements to the wholesale price for machinery, equipment, and related spares that are exported to hard currency countries, starting in 1986.

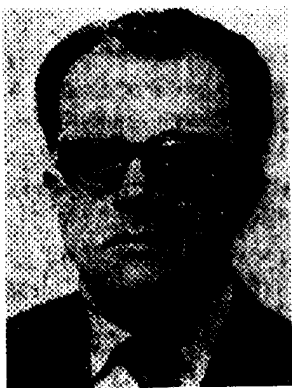
25X1

Secret



Secret

**Boris Ivanovich Aristov,  
the New Foreign Trade Minister**



Izvestiya ©

Aristov, 60, was named on 19 October to succeed the ailing Nikolay Patolichev, 77, who had held the position for 27 years. Aristov's appointment is another move in Gorbachev's campaign to replace the aged party and government leadership with energetic, progressive younger men whose loyalties are to Gorbachev rather than to the organizations they have been selected to manage. Aristov can be expected to implement foreign trade policies consistent with any efforts by Gorbachev to reform the Soviet economic system.

[redacted]

An East European specialist with no formal foreign trade experience, Aristov was ambassador to Poland from 1978 to 1983. Since 1983, he had served as a

Deputy Minister of Foreign Affairs responsible for relations with socialist countries. With his background, Aristov could be expected to actively promote trade strategies oriented toward Eastern Europe. [redacted]

25X1

Before his posting to Poland, Aristov had worked for 25 years in the Leningrad party apparatus, rising to the status of heir apparent to then first secretary of the Leningrad obkom Grigoriy Romanov. In 1971, Aristov became a full Central Committee member, probably with Romanov's backing. Friction reportedly developed, however, as Romanov came to view his protegee as too ambitious; [redacted]

25X1

[redacted] it was Aristov who "blew the whistle" on Romanov after the notorious 1978 wedding reception for Romanov's daughter at which antique china from the Hermitage was broken. Aristov's posting to Poland, which Romanov may have engineered, was viewed by many as a demotion. According to a Soviet embassy official in Eastern Europe, Aristov was highly regarded by former General Secretary Andropov, who may have been responsible for Aristov's return from Poland and appointment to the Foreign Ministry post in July 1983. [redacted]

25X1

25X1

25X1

- Assurances that Soviet enterprises will have access to foreign currency that they have earned from delivery of export products. [redacted]

Whether these changes will have the intended impact of boosting the quality and quantity of exportable goods remains to be seen. On the basis of past reform efforts, the decree may not contain sufficient incentives to induce producers to be more responsive to export demands (see inset on previous reform efforts of the foreign trade structure). It remains to be seen whether the leadership can resolve the key problem of conflicting goals facing enterprise managers, the most

important of which are the output targets (measured in quantity). In addition, by assuring enterprises they will have access to the foreign currency they have earned, the Soviet leadership is basically admitting that access to these earnings has been circumscribed in the past. Whether enterprises will now have easier access to hard currency—as judged by their ability to spend it as they see fit—depends largely on the willingness of the Bank for Foreign Trade—which authorizes hard currency expenditures—and the Ministry of Foreign Trade—which does the actual buying—to abide by the decree. [redacted]

25X1

25X1

Secret

Secret

---

***Reform of the Foreign Trade Bureaucracy  
in the Mid-1970s***

*Every Soviet regime has been confronted with serious bureaucratic problems in approaching foreign trade, but it was at the height of detente and its burgeoning East-West trade that the need to address the situation was acknowledged to be particularly acute. By 1976, a debate of several years' duration on the need for reform aimed at improving the USSR's export performance culminated in a Politburo decree on the management of foreign trade. Although the text of the decree has never been made public, the speeches of General Secretary Brezhnev and Premier Kosygin to the 25th Party Congress indicated that a general decision had been made to enlarge the role of the industries in foreign trade decisionmaking and to make other changes to increase the responsiveness of the FTOs and the ministries to foreign markets. According to Soviet economists, specific provisions included putting FTOs on a strict cost-accounting basis, establishing a board of directors in each FTO with equal representation from the Ministry of Foreign Trade and branch ministries, and reorganizing FTOs' trade offices as export-import firms with the power to negotiate for their respective FTO.*

*These changes in the foreign trade system were delayed, however, primarily because of opposition from the Ministry of Foreign Trade to what it regarded as attempts to encroach on its turf. A directive was finally issued by the Council of Ministers in early 1978 that required the Ministry to reorganize the FTOs according to the Politburo decree by the end of the following year. The extent of the reform, however, was later reported to have been far less than what was envisioned in the early 1970s. At present, the Soviet system remains the closest in the Soviet Bloc to the highly centralized "classical" model of foreign trade in a planned economy.*

---

Perhaps a more far-reaching development is the announcement of a novel and ambitious economic management experiment at the Fiat-built Tol'yatti Automotive Plant. According to Izvestia, managers will be given greater responsibility in planning and control over earnings and spending. Under the terms of the experiment, the plant will be allowed to retain 40 percent of its hard currency earnings and, according to a businessman who has had dealings with the plant, will be allowed to sign its own contracts with foreign suppliers without the intervention of the central ministries or the FTOs. Thus, on a very limited scale, this experiment decentralizes foreign trade decisionmaking away from both the Foreign Trade Ministry and an industrial ministry and ties the enterprise much closer to the international market. [ ]

25X1

While the Tol'yatti experiment represents efforts to decentralize some aspects of decisionmaking, it is uncertain whether the central planners will be willing to delegate sufficient authority to the plant managers to make the experiment work.<sup>6</sup> Even if it succeeds, conducting it on a broad scale would meet strong resistance. Both party and government officials may fear that a large number of enterprises engaging independently in foreign trade would wreak havoc with the centralized planning system as well as the monopoly of the foreign trade bureaucracy. Certainly, any effort to decentralize foreign trade would run into strong opposition from the Foreign Trade Ministry, the Bank for Foreign Trade, and Gosplan. [ ]

25X1

25X1

[ ], only a small share of production—about 5 percent—is available for export to hard currency countries. Thus in reality there would be little foreign exchange available for the enterprise. [ ]

25X1

25X1

25X1

Secret

Secret

**Dealing With the West**

There is increasing evidence that the Soviets may be considering proposals to expand the types of their economic dealings with Western firms. [redacted]

[redacted] Soviet think tanks are studying joint-venture arrangements that, while not equity arrangements, would give Western firms many of the same advantages. In return for selling, or possibly leasing, technology and equipment for a particular plant, the Western participant would receive royalties on production distributed in the USSR and would share in the profits from production that is exported. In a recent article on Soviet-Japanese economic relations, former Deputy Foreign Trade Minister Sushkov raised the possibility of construction or modernization of Soviet facilities to produce goods for sale in Japan or of joint production of certain types of machines. While these proposals give no indication of the amount of access that the USSR would be prepared to grant, these types of arrangements would require a long-term relation with the firms involved. [redacted]

The Soviets also have raised more concrete proposals with Western firms that could point to new directions in Soviet trade, including the possibility of joint ventures that could entail Western managerial presence and profit sharing. [redacted]

[redacted]

Soviet officials also have become more interested in seeking contracts that would tap into Western managerial expertise. [redacted] Soviet officials in the gas and petroleum ministries recently expressed interest in some "soft" technology packages that would include engineering and production consultation for oil and gas field development. [redacted]

[redacted] Soviet trade officials have expressed interest in having a Western petroleum equipment firm set up a training school in Murmansk and conduct classes in the drilling, completion, and operation of offshore wells. [redacted]

**Obstacles to Increased Western Participation**

To successfully implement an expanded range of ties to the West, Gorbachev would have to overcome considerable resistance. A new approach to trade would require reform of the foreign trade structure along the lines discussed above. Moreover, the Soviets would have to overcome their deeply rooted suspicion of foreign presence in the USSR if they are to grant a greater degree of access than is currently the case. Of the various proposals that the Soviets could consider, the least likely to be adopted would be equity ventures, either in the USSR or abroad—especially in the LDCs. Although a number of East European countries have entered into joint-equity ventures with Western firms, these types of cooperation arrangement go against the ideological underpinnings of the

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Secret

Secret

Soviet state.<sup>8</sup> Capitalist ownership—even if only very small—is apt to be repugnant to most Soviet officials. Similarly, Soviet equity in the LDCs would go against the principles of “nonexploitive” assistance to these countries (that is, ownership remains in the hands of the recipient country), which Moscow espouses. Even nonequity joint ventures at a minimum would require that such terms as profits and royalty be changed to ones that are ideologically acceptable. [ ]

While some Western firms would be willing to consider Soviet proposals involving coproduction, especially those producing machinery and equipment, all would approach such ventures with considerable caution. On-site inspection would be a must for most of these firms, and few, if any, would be willing to rely on the Soviets to be the sole supplier of key components. [ ]

Joint-equity ventures or other profit-sharing arrangements, if offered, would likely attract only the larger multinational companies, at least initially, and Soviet law would first have to guarantee that profits earned by the Western participants could be repatriated and ensure that taxes were not onerous. [ ]

[ ] bankers appear to be the most reluctant to participate in either coproduction arrangements or joint-equity ventures. According to the US Embassy in Bern, Swiss bankers would only underwrite joint-equity ventures in the USSR if they could get government export risk guarantee insurance or if the Swiss firms involved would accept the financial risks themselves. [ ]

The businessmen interviewed cited a wide array of problems within the Soviet system that would impede the successful implementation of cooperative ventures. They expressed considerable skepticism that the Soviets would grant them the amount of access to domestic producers that they consider necessary. They complained of poor Soviet production and the

<sup>8</sup> Several of the East European countries have legislation permitting joint-equity ventures with Western firms on their territory. To date, there are only a limited number of such jointly owned companies, and, while some ventures have been successful, the arrangement has not yet proved to be particularly profitable for either Western firms or the East European participants. Some East European countries are currently exploring new joint-venture legislation to make these arrangements more attractive to Western investors. [ ]

unreliability of the USSR as a supplier. It was almost universally believed that at the heart of the matter was the lack of motivation on the part of Soviet managers and workers to efficiently produce goods of acceptable quality. Substantial improvements in the operation of the domestic economy would probably be necessary before large numbers of firms would agree to cooperation arrangements that closely tie the Western participant's profits to the successful operation of the venture.<sup>9</sup> [ ]

The Soviets appear to be caught in a vicious circle. Better use of Western technology and equipment, which can best be achieved through closer cooperation with the West, is needed to improve economic performance. Sizable and sustained increases in Western participation may not be forthcoming, however, because of the very gaps in economic performance Moscow is seeking to correct. [ ]

#### Prospects: A Middle Ground

Gorbachev's current efforts to break this circle appear to be twofold: he is attempting to improve economic performance through better incentives and greater discipline while broaching the possibility of new forms of cooperation with Western firms. To be successful, new initiatives must be bold enough to attract Western firms but staid enough to be politically acceptable. Because of domestic political constraints, any changes in foreign trade policy are likely to be slow and incremental. New proposals will probably be limited at present to critical sectors where the payoff is clear. [ ]

At the same time, Gorbachev may try over time to develop (largely through personnel changes) a political environment receptive to bolder changes than the system is now prepared to make. Indications that he is moving in this direction would include:

- More decentralization of foreign trade decisionmaking coupled with a reorganization of the Foreign Trade Ministry.
- Relaxation of joint-venture rules.

<sup>9</sup> COCOM restrictions also will prevent the sales of some advanced technology that the Soviets may desire. [ ]

Secret

**Secret**

- Press coverage of the potential benefits from joint ventures or favorable analysis of joint ventures in Eastern Europe.
- Signing of cooperation agreements with Western firms—including joint ventures—that would expand the role of Western firms in Soviet production.

[redacted]

Alternately, Gorbachev could permit innovative arrangements on a very selective basis to solve narrowly defined problems. Such a policy would allow the Soviets to address specific problems in handling imported technology and expanding exports without entailing broad structural changes in the economy. Turnkey projects, for which the Soviets have shown considerable interest, accomplish this goal by assigning to the Western firm all the responsibility for construction and equipment installation. Other actions that would be indicative of this approach include:

- Establishment of enterprises specializing in export production that would have greater access to international markets. Such a policy was under discussion in the mid-1970s, but rising energy prices in the late 1970s temporarily lessened the need to expand exports of manufactured commodities. Perhaps the experiment at the Tol'yatti factory is a step in this direction.
- A joint venture in the USSR for the fabrication of imported equipment that would be managed by the foreign partner. Such a setup would assure that basic tools needed for fabrication of Western equipment would be available.
- Contracts with Western companies for the maintenance of inventories of spare parts for imported equipment at regional distribution centers inside the USSR. [redacted]

#### **Implications for the United States**

A step-up of Soviet purchases of machinery and equipment would probably lead to increased sales by US firms. Already this year Soviet orders from US firms have picked up as overall Soviet purchases from the West have surged. If Gorbachev's plans include

wide-scale use of Western technology coupled with new approaches to trade with the West, prospects for US sales would be brighter. Several West European businessmen felt that joint-equity ventures would be more attractive to US firms than to most West European firms. Some US businessmen also feel that US firms are better suited than other Western firms to offer the "bigness" in both projects and money that the Soviets may desire. To the best of our knowledge, recent Soviet interest in joint ventures has been broached mainly with US firms. Soviet officials also continue to express—at least to US businessmen—their preference for US technology. [redacted]

25X1

25X1

The Soviet leadership may view expanding trade with the United States as a way to improve overall bilateral relations. A recent US business delegation to the USSR was treated royally. The overriding message to the delegation was that the Soviets were very interested in doing business if obstacles to technology sales could be removed. There was, nonetheless, a tacit acceptance on the Soviet part that some limitations to technology trade would remain. In contrast to experiences of other US businessmen who have been told that movement on arms control issues was essential, little reference was made to the need for improvement on other bilateral issues. While the Soviet message probably was geared toward setting the atmosphere for the Reagan-Gorbachev meeting, the delegation was originally invited by the Soviets prior to a decision on the meeting. [redacted]

25X1

Soviet views concerning the long-term prospects for bilateral political relations are likely to temper Moscow's expectations for expanded trade ties and initiatives aimed at encouraging them. Although recent movement on sanctity-of-contract issues will be somewhat encouraging to the Soviets, their experience with US sanctions in the past probably has left them permanently wary of becoming heavily dependent upon US supply of essential commodities, and their purchasing decisions will continue to be influenced by the need to maintain diverse sources.<sup>10</sup> [redacted]

25X1

25X1

25X1

[redacted]

**Secret**

**Secret**

The Soviets doubtless hope that, over the longer term, relations could improve to the point where they would be granted most-favored-nation status, but they realize that for now this is not a likely prospect. They also are unlikely to harbor any hope that the present US administration will soon ease restrictions on export of goods deemed strategically significant, although they probably believe that the influence of the US business community eventually will work to their advantage on this issue.<sup>11</sup> Indeed, the Soviets have at times been quite transparent in their efforts to influence government policy through the business community on issues such as technology restrictions and arms control by promises of increased trade.

25X1

<sup>11</sup> In fact, few of the projects now under consideration with US corporations fall into the strategically significant category.

25X1

**Secret**

**Secret**

**Secret**